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No. 87-543

In the Supreme Court of the United States

OCTOBER TERM, 1987

TRANSWESTERN PIPELINE COMPANY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission properly determined that the fixed-cost minimum bill provisions contained in petitioner's rate schedules are not "just and reasonable" and are therefore unlawful (see 15 U.S.C. 717c(a)).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A27) is reported at 820 F.2d 733. The initial opinion of the Federal Energy Regulatory Commission (Pet. App. C1-C47) is reported at 32 F.E.R.C. ¶ 61,009. The Commission's opinion on rehearing (Pet. App. D1-D63) is reported at 36 F.E.R.C. ¶ 61,175. The opinion of the administrative law judge (Pet. App. E1-E42) is reported at 29 F.E.R.C. ¶ 63,054.

JURISDICTION

The judgment of the court of appeals (Pet. App. B1) was entered on July 7, 1987. The petition for a writ of certiorari was filed on October 5, 1987. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. a. The rates charged by natural gas pipelines generally consist of two basic components. A "demand

charge" is imposed upon all customers who are entitled by contract to receive a specified amount of natural gas from the pipeline. This charge is a fixed sum, assessed in proportion to the maximum quantity of gas the customer is entitled to demand under the contract. The demand charge thus recoups some portion of the fixed costs incurred by the pipeline in providing facilities of sufficient capacity to meet the customer's peak-load entitlement.

The second component of pipelines' rates is the "commodity charge" levied upon each unit of gas sold. It is through this charge that a pipeline recovers its variable costs as well as the fixed costs that are not recovered through the demand charge. Some pipelines include in their rate schedules a specific type of commodity charge known as a "minimum commodity bill." These minimum bill provisions essentially establish a minimum commodity charge, requiring the customer to pay for a certain quantity of gas even if the customer does not take delivery of any gas during the relevant time period.

Before 1984, minimum bill provisions typically required pipeline customers to pay the full commodity charge for the quantity of gas specified in the minimum bill; they thus allowed a pipeline to recover its variable costs as well as its fixed costs. A rule issued by the Commission in 1984 eliminated minimum bills to the extent those provisions permitted the recovery of variable costs. See *Wisconsin Gas Co.* v. *FERC,* 770 F.2d 1144 (D.C. Cir. 1985), cert. denied, 476 U.S. 1114 (1986). The Commission did not there address the question whether pipelines should be permitted to recover fixed costs through minimum bills, leaving that issue for case-by-case adjudication.

b. Petitioner owns and operates an interstate natural gas pipeline. Virtually all of its gas is sold to two customers—Southern California Gas Company (SoCal) and Northwest Central Pipeline Company (NWC), each of which also purchases gas from other sources. Petitioner's

rates have typically included a demand charge, which recovered 50% of petitioner's fixed transmission costs; and a commodity charge, which recovered (a) all remaining fixed transmission costs, (b) all fixed production costs, and (c) all variable costs. The commodity charge included a minimum bill provision requiring SoCal and NWC to pay the commodity charge for approximately 90% of the quantities of gas to which these customers were entitled under their contracts. Thus, regardless of the amount of gas that they actually purchased from petitioner, these customers were obligated to pay for nearly all of the gas covered by their contracts.

In August 1981, petitioner filed increased rates pursuant to Section 4 of the Natural Gas Act, 15 U.S.C. 717c. The reasonableness of the minimum bill provisions was the subject of a hearing before an administrative law judge. After the Commission promulgated its rule eliminating recovery of variable costs through minimum bills, the administrative law judge issued a decision allowing petitioner to include in its rate schedules minimum bills that recovered the fixed cost portion of petitioner's commodity charge for 60% of the quantity of gas required to be supplied under its contracts (see Pet. App. E1-E42).

2. The Commission ordered the elimination of the minimum bills recovering petitioner's fixed costs, directing petitioner to use a new rate methodology to recover its fixed costs (Pet. App. C1-C47; see also *id.* at D1-D63 (order on rehearing)). The Commission reached this conclusion on the basis of its determination that petitioner's minimum bills were unjust and unreasonable because they would have the effect of unreasonably restricting competition (see *id.* at C25-C27, D21).[1]

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[1] The Commission also concluded that the minimum bill provisions impermissibly discriminated between petitioner's customers (see Pet. App. C8-C21, D3-D20).

The Commission first found that the minimum bills would "foreclos[e] competition and restrain[] trade" (Pet. App. C25). It stated that a minimum bill typically has the effect of foreclosing other suppliers from selling to the customers bound by the minimum bill and is therefore economically indistinguishable from a requirements contract; such a contract is an unreasonable restraint of trade under the antitrust laws if "it is 'more restrictive than necessary to meet an objective meriting antitrust recognition' " (*id.* at C25 n.69 (citation omitted); see also *id.* at D23-D24). The Commission concluded that petitioner's minimum bills were in fact likely to affect petitioner's competitors and customers adversely, stating that "in a situation where supply exceeds demand [the situation in the natural gas markets relevant in this case] a requirements contract has competitive significance, for the effect is to foreclose competitors from the market" (*id.* at C26 n.71). The Commission observed that it had forbade recovery of variable costs through minimum bills, but stated that a minimum bill limited to recovering fixed costs would "still * * * have adverse consequences on competition. To become competitive [petitioner] will not have to reduce the price of its gas to the level of its competitor's price. Instead, all [petitioner] will have to do is to reduce the price of its gas so that it equals the price of its competitor's gas plus the minimum bill payments. This will result in an inefficient allocation of resources." *Id.* at C27 n.71; see also *id.* at D25-D29.

The Commission next considered whether the minimum bill provisions served some permissible purpose and therefore should be permitted to stand despite their anticompetitive effect. It stated that a minimum bill "may be justified as a means of protecting the pipeline against the risk of not recovering the fixed costs in the commodity component" (Pet. App. C27). The Commission acknowledged that petitioner's minimum bills would have

the effect of assuring the recovery of 50% of petitioner's fixed transmission costs, but stated that "the point of this justification [for minimum bills] is not simply to assure the recovery of fixed costs. If it were, a 100 percent minimum bill would be justified in all cases" (*id.* at C28). The Commission stated (*id.* at C28-C29 (footnote omitted)) that

> [i]n light of the justification's purpose, the most that can be said about the amount of fixed costs whose recovery should be assured is that the amount should be no greater than the costs of depreciation and of servicing the debt. It must also be said that in light of the justification's purpose the amount of fixed costs whose recovery should be assured should in no way act to assure recovery of the return on equity, related income taxes, and fixed production costs. These elements of the cost of service should be at risk to give the pipeline an incentive to minimize its costs.

The Commission found that petitioner's minimum bills were not limited in this manner: the provisions permitted recovery of all fixed costs. The Commission further found that "a minimum bill is unnecessary to assure recovery of the amount of fixed costs [petitioner] should recover" (Pet. App. C29). A "modified fixed-variable [rate] methodology" would allow petitioner to recover "all fixed costs except return on equity, related income taxes, and, perhaps, production related costs" by recovering those costs through the demand charge (*ibid.*). "Thus, [petitioner] would be assured of recovering all of the fixed costs it should recover without having to impose a minimum bill" (*ibid.* (footnote omitted); see also *id.* at D35-D36).[2]

The Commission also concluded that petitioner's minimum bills could not be justified on the ground that they

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[2] The fixed costs not included in the demand charge, together with all variable costs, would be recovered through the commodity charge.

allocated petitioner's take or pay obligations to the customers that caused the liabilities to be incurred.[3] It stated that there was "no connection between the minimum bill payments the customers would make and the carrying costs associated with take-or-pay liabilities [petitioner] could legitimately recover from them." Pet. App. C31; see also *id.* at D41-D44.

Finally, the Commission held that the minimum bills could not be justified on the ground that they placed petitioner on an equal footing with a competitor that, by virtue of the provisions of the settlement of its rate proceeding, had a similar minimum bill in its rate schedules. The Commission stated that "[t]o set just and reasonable rates requires a decision as to what is fair to both the pipeline and consumers. To set the pipeline's minimum bill on the basis of the minimum bills other pipelines have eliminates consumers as a factor to be considered. This we decline to do" (Pet. App. C32 (footnote omitted)). The Commission also noted that petitioner was a financially strong company that would not be placed in economic jeopardy by the elimination of its minimum bills. If petitioner were allowed to include a minimum bill in its rates on the ground that a similar provision was contained in its competitor's rate schedule, moreover, the competitor

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[3] "Take or pay" costs can result when the pipeline's contract with its supplier provides that the pipeline will take a particular amount of gas or pay for that amount of gas. If the pipeline's sales decrease, the pipeline may not take the required quantity of gas and may be forced to make "take or pay" payments to its supplier. If the pipeline does incur take or pay costs, these costs generally may be included in the pipeline's rate base; the take or pay costs are treated as an investment upon which the pipeline may earn its prescribed rate of return. The typical take or pay contract provision then allows a pipeline five years to take delivery of the gas for which it has prepaid. If the pipeline fails to take delivery of the gas within the required period, it can recover prudently incurred take or pay costs.

would later be entitled to maintain its minimum bill on the ground that such a provision was included in petitioner's rates. "Thus, as if by transmutation, an uncontested settlement on the minimum bill issue that we accepted to resolve a case would become the just and reasonable minimum bill for [petitioner's competitor]. We will not allow ourselves to be so bound" (*id.* at C35).

The Commission concluded that "the inclusion of minimum bills in [petitioner's] rate schedules is not justified and that none should be included" (Pet. App. C36). It stated that petitioner's rates should be redesigned using the modified fixed-variable method. That approach would allow petitioner to recover through the demand charge all of its fixed costs other than return on equity, related income taxes, and production related fixed costs.

3. The court of appeals unanimously upheld the Commission's determination (Pet. App. A1-A27). It found that the Commission had correctly concluded that petitioner's minimum bill provisions are anticompetitive, stating that "[t]he evidence was sufficient to support the Commission's finding that even fixed-cost minimum bills could coerce SoCal and Northwest into purchasing higher-cost gas from [petitioner] instead of alternative, lower-cost supplies" (*id.* at A22).[4]

The court also agreed with the Commission's conclusion that there was no countervailing justification for petitioner's minimum bills. It found that the minimum bills could not be upheld as necessary to recover fixed costs, because the bills "recovered costs which did not warrant risk-free recovery" (Pet. App. A15). Under the Commission's modified fixed-variable rate design, "all fixed costs which [petitioner] should recover will be recovered through the demand charge without the imposition of a

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[4] The court rejected petitioner's contention that there was no evidence before the Commission regarding the competitive impact of fixed-cost minimum bills (Pet. App. A21-A22).

minimum bill" (*id.* at A16). The court found that the Commission's decision did not deny petitioner a reasonable opportunity to earn a profit; "[t]he Commission has only refused to protect [petitioner's] profit from competition and provided [petitioner] what the Commission determined to be the appropriate incentive to run its business efficiently" (*id.* at A17).

The court also upheld the Commission's conclusion that the minimum bills were not justified as a means of allocating take or pay liabilities. It observed that the allocation of these liabilities "is a separate matter which is being addressed in other proceedings before the Commission and through other means. Indeed, [petitioner] currently has a proposal before the Commission to allocate costs of settling take-or-pay liability directly to the customers who caused such costs to be incurred. The Commission is not ignoring the issue" (Pet. App. A20). The court also stated that petitioner's minimum bills did not involve "any proper take-or-pay justification" (*ibid.*) because the minimum bills did not equitably allocate take or pay risks. The court found the take or pay issue to be "hypothetical" because petitioner had not shown that it has been required to make *any* take or pay payments. For all of these reasons, the court determined that the Commission's decision to address this potential problem in other proceedings was reasonable.

Finally, the court stated that the minimum bills could not be justified by reference to the rates charged by petitioner's competitor. On that theory, the court stated, the competitor would later be able to justify its minimum bill provision by reference to petitioner's rates. "This ping-pong effect could mean that consumers would never be free of the unwarranted cost" (Pet. App. A21). The court observed that, pursuant to a settlement, the competitor's minimum bills "will be placed at the same level as [petitioner's], which means they both will be eliminated" (*ibid.*).

The court stated that "[t]he Commission's conclusion that [petitioner's] minimum bills unreasonably restrained trade was based on substantial evidence. * * * The Commission's decision to eliminate [petitioner's] minimum bills in their entirety was neither arbitrary nor capricious, but was a proper exercise of the Commission's authority to regulate rates and practices of interstate pipelines under the Natural Gas Act" (Pet. App. A26-A27).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or another court of appeals. Review by this Court is not warranted.

1. Petitioner first contends (Pet. 10-14) that the Commission's decision is inconsistent with this Court's decisions in *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. 348 (1956). Petitioner's claim—that these decisions limit the Commission's authority to eliminate contractual rate provisions found to be unjust and unreasonable—is simply wrong.

The *Mobile-Sierra* doctrine holds that when a utility agrees to sell power at a fixed rate, it is bound by that contract provision even if a rate increase would be permissible under the applicable statutory standard (see *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. at 343-344). On the other hand, where the contract between a utility and its customer provides for sales "*not* at a single fixed rate * * * but at what in effect amount[s] to [the utility's] 'going' rate," the utility remains free to file new rate schedules pursuant to the statutory scheme (*United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Division*, 358 U.S. 103, 110 (1958) (emphasis in original)). Petitioner admits that its contracts, like those before the Court in *Memphis*, permit petitioner to file new rate schedules and permit petitioner's customers to challenge

any newly filed rates (see Pet. 12-13). Because the contracts do not limit the rights of either petitioner or its customers, the *Mobile-Sierra* doctrine is not implicated in this case.

Petitioner's argument is flawed for a second, more fundamental, reason. The *Mobile-Sierra* doctrine is a limitation upon a utility's authority to initiate a rate increase. It does not limit the Commission's express statutory authority to eliminate contract provisions that are unjust and unreasonable. See 15 U.S.C. 717d(a); *FPC* v. *Sierra Pacific Power Co.*, 350 U.S. at 355 (the Commission may abrogate a fixed-rate contract if "the rate is so low as to adversely affect the public interest"). For all of these reasons, the Commission properly assessed the minimum bill provision under the "just and reasonable" standard set forth in Section 5(a) of the Natural Gas Act, 15 U.S.C. 717d(a). See *Mississippi Industries* v. *FERC*, 808 F.2d 1525, 1552-1553, reh'g granted on other grounds, 822 F.2d 1104 (D.C. Cir. 1987), cert. denied, No. 86-1380 (Dec. 14, 1987); Pet. App. C16-C17.[5]

2. The Commission's conclusion that petitioner's minimum bills are unjust and unreasonable, unanimously upheld by the court of appeals, is amply supported by the comprehensive analysis contained in the decisions below. See Pet. App. A10-A22, C21-C38, D20-D62. Petitioner's challenges to the Commission's determination are

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[5] Petitioner intimates (Pet. 11-12) that Section 7 of the Natural Gas Act, 15 U.S.C. 717f, which concerns the issuance of certificates of public convenience and necessity, is somehow relevant to this issue. As the court of appeals explained, "Section 7 does not guarantee that the original conditions upon which the certificate was authorized will never change. Section 5 of the [Natural Gas Act] expressly empowers the Commission to change rates or practices, such as the fixed-cost minimum bills at issue here, if such provisions become unjust and unreasonable" (Pet. App. A26 (citations omitted)).

meritless.[6]

a. Petitioner contends (Pet. 14-15) that the Commission's finding that minimum bills are anticompetitive is not a sufficient basis for holding those rate provisions unjust and unreasonable under Section 5(a).

The Commission does not enforce the antitrust laws and is not bound by antitrust standards. See *California* v. *FPC*, 369 U.S. 482, 485-486 (1962). But the Commission must consider the impact of rates upon competition in determining whether those rates are just and reasonable. *FPC* v. *Conway Corp.*, 426 U.S. 271, 279 (1976); *Gulf States Utilities Co.* v. *FPC*, 411 U.S. 747, 757-759 (1973); *Northern Natural Gas Co.* v. *FPC*, 399 F.2d 953, 961 (D.C. Cir. 1968) (Commission must consider antitrust policies as "important element of the 'public interest' "). The anticompetitive effect of the minimum bills is therefore highly relevant in determining whether those provisions are unjust and unreasonable.

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[6] Petitioner claims (Pet. 18-19) that the Commission failed to explain its departure from an alleged "longstanding practice" of approving minimum bills. As the Commission itself observed, "[t]he problem with this contention is that the Commission has never had a general policy of accepting minimum bills. Instead, the Commission has assessed minimum bills in light of the particular facts of the pipeline. That assessment has often led the Commission to accept minimum bills. But [it] has also led the Commission to reject proposed minimum bills, modify existing minimum bills, and reject existing minimum bills" (Pet. App. D56-D57 (footnotes omitted)). Petitioner does not even attempt to show that the Commission's decision in the present case is inconsistent with those prior fact-bound determinations. See *id.* at D57-D59. Even if such an inconsistency could be shown, the reasoning in the Commission's opinions in the present case, together with the Commission's comprehensive reexamination of minimum bills in connection with the promulgation of the rule eliminating variable cost recovery through minimum bills (see page 2, *supra*), provides all of the necessary analytical support for the Commission's conclusion here.

Moreover, the Commission did not find the minimum bills unjust and unreasonable merely because those provisions restrict customers' choices in purchasing gas. It applied a "rule of reason" and balanced the competitive harm against all potential justifications for the minimum bills. Only after it concluded that there was no justification for the minimum bills did the Commission find the provisions unjust and unreasonable. See Pet. App. A13-A14.[7]

b. Petitioner also argues (Pet. 19-22) that the Commission erred by addressing on the present record the competitive effect of the fixed-cost minimum bills. At the time of the hearing, the minimum bills contained in petitioner's rate schedules recovered both fixed and variable costs; petitioner claims that the Commission therefore had no basis for determining the probable competitive impact of minimum bills that recover only fixed costs (*id.* at 21-22).

As the court of appeals explained, "[f]ixed costs are part of full-cost minimum bills" and the "question whether full-cost minimum bills should be entirely eliminated necessarily encompasses the question whether the fixed-cost portion should be eliminated" (Pet. App. A22). The court observed that some of the parties who participated in the hearing sought the elimination of minimum bills in their

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[7] Petitioner asserts (Pet. 16-17) that the Commission erred in looking to *Atlantic Seaboard Corp.*, 38 F.P.C. 91, 95 (1967), aff'd, 404 F.2d 1268 (D.C. Cir. 1968), for the possible justifications for minimum bills. (The Commission determined in that case that a minimum bill may be justified as a means of ensuring a pipeline's recovery of fixed costs, protecting full-requirements customers from higher rates, and ensuring equitable recovery of take or pay costs (see Pet. App. A15).) But that claim rests upon petitioner's mistaken belief that the *Mobile-Sierra* doctrine requires the application of some form of heightened scrutiny in this case (see Pet. 17). In any event, the Commission did not confine itself to the three justifications set forth in *Atlantic Seaboard Corp.*, but instead considered all possible justifications, including one articulated by the administrative law judge and supported by petitioner (see Pet. App. A21, D44-D48).

entirety, while others only challenged the recovery of variable costs through minimum bills. Since the permissibility of fixed-cost minimum bills was therefore a separate issue at the time of the hearing, the court concluded that petitioner "had a full, fair opportunity to present evidence on the lawfulness of its fixed cost minimum bills." *Ibid.*

The Commission concluded that the fixed-cost minimum bills were anticompetitive based on (a) evidence that the purpose and effect of the full-cost minimum bills was to force customers to purchase gas from petitioner rather than from lower-cost sources, and (b) its prediction that the fixed-cost minimum bills will have a similar, though reduced, impact (Pet. App. C26 n.71, D25-D29; see also *id.* at A11-A13). Petitioner's position is that the Commission should not be permitted to rely upon relevant past experience to make reasonable predictions about the future. But administrative agencies obviously are entitled to base their decisions upon predictions that result from the application of their expertise to the problem at hand. See, *e.g.*, *Wisconsin Gas Co.* v. *FERC*, 770 F.2d 1144, 1158 (D.C. Cir. 1985), cert. denied, 467 U.S. 1114 (1986).[8]

c. The Commission considered and rejected four possible justifications for petitioner's minimum bills; petitioner challenges the Commission's analysis in only two respects.

First, petitioner argues (Pet. 23-25) that the Commission failed to address the take or pay consequences of eliminating the minimum bills. But the Commission did consider the take or pay issue, and concluded that even if

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[8] Petitioner contends (Pet. 21) that the Commission's reasoning applies to "every pipeline's minimum bill." However, other pipelines may be able to show that different facts warrant a different result. And the fact that the same result would obtain in some, or even most, cases does not indicate that the Commission's reasoning here was flawed.

petitioner had proven that it had a take or pay problem, the minimum bills would be an inappropriate means to address the issue because they would not allocate take or pay costs to the customers who cause the pipeline to incur those costs (see Pet. App. C31, D41-D44). Moreover, the court of appeals properly found that the take or pay issue is "hypothetical" here because there is no evidence that petitioner has ever been required to make a take or pay payment (Pet. App. A20). Since petitioner's "potential take-or-pay problem" would not be equitably resolved by the minimum bills and the take or pay issue is currently before the Commission in ongoing cases, the Commission's decision to address the problem "through alternative approaches and in other cases" is not "unreasonable, arbitrary, or capricious" (*ibid.*; see also *Wisconsin Gas Co.* v. *FERC*, 770 F.2d at 1159-1160).[9]

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[9] Petitioner asserts (Pet. 25) that the court of appeals' decision is in "conceptual conflict" with *Associated Gas Distributors* v. *FERC*, 824 F.2d 981 (D.C. Cir. 1987) and *Consolidated Edison Co.* v. *FERC*, 823 F.2d 630 (D.C. Cir. 1987). These cases concerned new, industry-wide regulatory policies adopted by the Commission in part because it found that the policies would alleviate pipelines' take or pay problems (see *Consolidated Edison Co.*, 823 F.2d at 641), or would not exacerbate those problems (see *Associated Gas Distributors*, 824 F.2d at 1023). The courts concluded that the Commission's findings were not supported by the record or the Commission's analysis. Because the administrative decisions could not be upheld on the rationale adopted by the Commission, the courts remanded those decisions for reconsideration. *Consolidated Edison Co.*, 823 F.2d at 641; *Associated Gas Distributors*, 824 F.2d at 1030. Here, by contrast, there was no evidence of any current take or pay problem, and the Commission found that any potential problem would not equitably be resolved by minimum bills. For those reasons, the Commission concluded that it was appropriate to address the take or pay issue in other proceedings. This case accordingly is completely different from those in which the Commission based its decision upon a determination regarding the take or pay issue that the reviewing courts found unsupported by substantial evidence. See *Wisconsin Gas Co.* v. *FERC*, 770 F.2d at 1159-1160 (Commission entitled to defer decision regarding appropriate method of addressing pipelines' potential take or pay liability).

Second, petitioner contends (Pet. 17-18) that the Commission erred by rejecting petitioner's claim that it should be entitled to include minimum bills in its rates because its competitor's rate schedules include minimum bills. The court of appeals agreed with the Commission that if a minimum bill is anticompetitive, "it cannot be justified on the basis that it meets one other competitor" because such a claim "ignores the consumers" (Pet. App. A21; see also *id.* at A23). If a pipeline could justify its own minimum bills on the basis of another pipeline's minimum bills, "consumers would never be free of the unwarranted cost" (*id.* at A21) of anticompetitive minimum bills. Because the primary purpose of the Natural Gas Act is "to protect consumers against exploitation at the hands of natural gas companies" (*FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944)), the Commission's rejection of this justification was proper.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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